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BELLSOUTH TELECOMMUNICATIONS, INC. S. C. PUBLIC SERVICE COMMISSION
REBUTTAL TESTIMONY OF WALTER S. REID
BEFORE THE
PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
DOCKET NO. 2001-65-C
JUNE 11, 2001

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EXECUTIVE DIRECTOR'S OFFICE

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8 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND
9 POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.

10
11 A. My name is Walter S. Reid and my business address is 675 West
12 Peachtree Street N. E., Atlanta, Georgia. My position is Senior Director
13 for the Finance Department of BellSouth Telecommunications, Inc.
14 (hereinafter referred to as "BellSouth", or "the Company").
15

16 Q. ARE YOU THE SAME WALTER S. REID WHO FILED DIRECT
17 TESTIMONY IN THIS PROCEEDING?
18

19 A. Yes. I filed direct testimony in this proceeding on behalf of BellSouth
20 on February 16, 2001.
21

22 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?
23

24 A. The purpose of my rebuttal testimony is to respond to the testimony
25 filed by Mr. Don Wood on behalf of New South Communications,

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1 NuVox Communications, Broadslate Networks, ITC^DeltaCom
2 Communications, and KMC Telecom regarding the appropriate amount
3 of shared and common costs to include in the total cost of unbundled
4 network elements ("UNEs") for BellSouth.

5
6 Q. WHAT WILL YOUR REBUTTAL TESTIMONY SHOW RELATIVE TO
7 MR. WOODS'S POSITIONS?

8
9 A. My rebuttal testimony will demonstrate that the adjustments that Mr.
10 Wood is proposing to BellSouth's shared and common costs are based
11 on misunderstandings and improper analysis of BellSouth's data.
12 BellSouth has only included a reasonable amount of forward-looking
13 shared and common costs in its UNE cost studies. Mr. Wood's flawed
14 analysis does not address the actual amount of shared and common
15 costs BellSouth has included in its UNE studies and it does not identify
16 the significant productivity improvement that is included in BellSouth's
17 calculations. Therefore, his proposed adjustments should be rejected.

18
19 Q. WHAT IS THE BASIS FOR YOUR COMMENT THAT MR. WOOD'S
20 ANALYSIS DOES NOT ADDRESS THE ACTUAL AMOUNT OF
21 SHARED AND COMMON COSTS INCLUDED IN BELL SOUTH'S UNE
22 STUDIES AND DOES NOT IDENTIFY THE SIGNIFICANT
23 PRODUCTIVITY IMPROVEMENT THAT IS INCLUDED IN
24 BELL SOUTH'S CALCULATIONS?

25

1 A. In performing his analysis, Mr. Wood fails to recognize the fact that
2 BellSouth's computational methodology for its shared and common
3 cost factors along with the application of these factors in the BellSouth
4 Cost Calculator result in a significant amount of productivity
5 improvement being considered in BellSouth's cost study. Mr. Wood
6 focuses his analysis on only one component of the calculation of
7 shared and common costs in UNE rates. His analysis, in addition to
8 having numerous other flaws, addresses only the expenses that are
9 included in the numerator of the shared and common cost factors.
10 However, this is not the dollar amount of shared and common cost
11 included in UNE rates. The actual amount of shared and common
12 costs included in UNE rates is significantly reduced from the level in the
13 numerator of the factors through the methodology BellSouth uses to
14 develop and apply the factors.

15
16 Mr. Wood's adjustments to BellSouth's shared and common cost
17 projections inappropriately double count possible future productivity
18 gains and result in unrealistically low levels of shared and common
19 costs in proposed UNE rates.

20
21 Q. HOW DOES BELL SOUTH'S COMPUTATIONAL METHODOLOGY
22 FOR SHARED AND COMMON COSTS CONSIDER PRODUCTIVITY
23 IMPROVEMENTS?

24
25

1 A. From a high level perspective, BellSouth's treatment of shared and
2 common costs assumes that the same magnitude of productivity
3 improvements can be obtained in shared and common costs as is
4 evident from going to a forward-looking efficient network from an
5 historical network. Although this assumption is not explicitly stated, it is
6 nevertheless observable in the detailed calculations.

7
8 Regarding the detailed calculations, I would first point out that the
9 shared cost factors used by BellSouth represent the relationship
10 between projected shared cost and projected historical investment
11 which has been restated to current cost levels. This calculation results
12 in forward-looking shared cost factors that are approximately 20%
13 lower than factors that would have been calculated if BellSouth had
14 merely used the relationship between projected shared cost and
15 projected historical investment. In addition, a similar treatment
16 regarding the common cost factor results in a forward-looking common
17 cost factor that is approximately 13.5% lower than a factor that would
18 have been calculated if the Company had not restated investments to
19 current cost. The common cost factor is the relationship between
20 projected wholesale common cost and projected total wholesale direct
21 and shared cost.

22
23 Q. CAN THE FACT THAT BELL SOUTH'S METHODOLOGY RESULTS IN
24 LOWER SHARED AND COMMON COST FACTORS BE VERIFIED
25 FROM THE DATA THAT HAS BEEN FILED IN THIS CASE?

1

2 A. Yes. A user of the shared and common cost model can determine the
3 value of the shared and common cost factors if investments had not
4 been restated to current cost levels. The user would change the current
5 cost to book cost ratios to equal 1 in excel file INVPRJ00.xls, redevelop
6 the investment development factors in excel file INVDFV00.xls based
7 on these results, and input the new investment development factors
8 into a shared and common cost scenario.

9

10 Q. HOW DOES THE APPLICATION OF THESE SHARED AND
11 COMMON COST FACTORS REFLECT THE PRODUCTIVITY
12 DIFFERENCE BETWEEN AN EFFICIENT FORWARD-LOOKING
13 NETWORK AND AN HISTORICAL NETWORK?

14

15 A. As I have previously discussed, because BellSouth's shared and
16 common cost factors are computed using investments restated to their
17 current cost, the factors are lower than if they had been calculated with
18 historical investments as the denominator of the factor. These lower
19 factors are then used in BellSouth's study by applying them to efficient
20 forward-looking investment amounts that are lower than historical
21 levels. The application of the factors in this manner further reduces the
22 level of shared and common costs included in the total cost of UNEs.

23

24 For example, assume that the ratio of projected shared cost to
25 projected historical investment for an account was 0.01. By restating

1 the projected investment to current cost levels, BellSouth would have
2 calculated the shared cost factor to be approximately 20% lower or
3 0.008. Further, assume that the historical investment for a loop was
4 \$1,000 and that the efficient forward-looking investment cost for a loop
5 is \$750. On an historical basis, the amount of shared cost that
6 BellSouth was experiencing would have been \$10 for the loop (i.e., .01
7 x \$1,000). However, BellSouth's cost study methodology in this case
8 would calculate a forward-looking shared cost for the loop of only \$6
9 (i.e., .008 x \$750). In this example, BellSouth would have to achieve a
10 40% productivity increase to break even on the amount of shared cost
11 included in the UNE costs versus historical levels. Therefore, Mr.
12 Wood's analysis which only looks at the numerator of the factor
13 development overstates the amount of shared and common costs
14 included in BellSouth's UNE rates by approximately 40%. His
15 proposed reduction to BellSouth's shared and common costs by
16 another 22% is clearly a double dip and is inappropriate.

17
18 Q. IN THE EXAMPLE YOU JUST USED, YOU ASSUMED THAT
19 FORWARD-LOOKING EFFICIENT INVESTMENT LEVELS ARE
20 LOWER THAN HISTORICAL LEVELS. IS THIS A REASONABLE
21 ASSUMPTION?

22
23 A. Yes. Based on the positions that have been taken by the parties in
24 UNE cost study proceedings, it is evident that everyone believes that
25 forward-looking efficient investment levels are lower than historical

1 levels. In the past, BellSouth has argued for increased rates to cover
2 actual costs, and opposing parties have argued that lower forward-
3 looking efficient cost should be used.

4
5 As a further test of this assumption, I compared the forward-looking
6 investment for the UNE loop plus port combo that BellSouth has filed in
7 this proceeding to the investment level assigned to the carrier common
8 line category in South Carolina's 1999 jurisdictional separations study
9 (FCC Form 43-01). In making this calculation, I had to convert the
10 interstate assigned amounts to combined levels by dividing by the
11 appropriate jurisdictional separation factor of 25%. This comparison for
12 South Carolina indicates that the forward-looking investment level for
13 outside plant and central office investment is approximately 73% of the
14 historical level.

15
16 Q. YOU INDICATED THAT MR. WOOD'S ANALYSIS CONTAINED
17 OTHER NUMEROUS FLAWS. CAN YOU IDENTIFY THESE?

18
19 A. Yes. Based on his analysis, Mr. Wood makes three other criticisms of
20 BellSouth's treatment of shared and common costs. First, he claims
21 that a best practices analysis should be done regarding 1998 data in
22 order to ascertain the appropriate starting point for projecting expenses.
23 Second, he claims that the Commission should require BellSouth to
24 use a productivity factor in its expense forecasts that is no less than the
25 FCC's last-approved 6.5% productivity factor. Finally, he claims that in

1 the expense projection that no inflation factor be applied in projecting
2 the cost of maintaining personal computers.

3

4 Q. ARE HIS CRITICISMS OF BELL SOUTH'S COST STUDY
5 REASONABLE?

6

7 A. No. A review of Mr. Wood's testimony reveals that he has performed
8 only a superficial analysis of BellSouth's treatment of shared and
9 common cost. His criticisms are not based on facts but instead result
10 from his misunderstandings of BellSouth's study.

11

12 Q. DOES MR. WOOD PROVIDE ANY REASONABLE EVIDENCE TO
13 PROVE HIS ASSERTION THAT BELL SOUTH'S EXPENSE LEVEL
14 INCLUDED IN ITS UNE COST IS NOT REFLECTIVE OF AN
15 EFFICIENT FIRM?

16

17 A. No. Mr. Wood has ignored the fact that BellSouth's calculated shared
18 and common cost factors are applied to the lower level of investment
19 and cost which result from pricing out the forward-looking efficient
20 network. As I previously explained, the development and application of
21 shared and common cost factors in BellSouth's study attributes the
22 same level of efficiencies and productivity to its shared and common
23 costs as is evident in the price out of the forward-looking network.

24

25

1 Mr. Wood's testimony implies that BellSouth's shared and common
2 costs need to be reduced by 22.12% based on his historical
3 comparison of BellSouth to other companies (Wood Testimony at page
4 51, lines 7-9). However, as I have demonstrated the actual amount of
5 shared and common costs included in BellSouth's study is
6 approximately 40% lower than the historical levels that would be
7 obtained from an analysis such as Mr. Wood's. Mr. Wood's conclusion
8 is unfounded and erroneous.

9
10 It is also important to note that Mr. Wood's proposed adjustment is not
11 performed in a logically consistent manner. He proposes that the
12 Commission reduce the numerator of BellSouth's shared and common
13 cost factors by 22% so that the projected expenses are reflective of a
14 forward-looking efficient firm, but he proposes no adjustment to the
15 denominator of the factor. In order for his proposed shared cost factor
16 development to have any logical consistency, he would also have to
17 make an adjustment to the projected investment in the denominator of
18 the factor to make it also reflective of a forward-looking efficient firm.
19 This further adjustment would eliminate the reduction in shared and
20 common cost he is proposing. However, without this further
21 adjustment to the denominator, his proposal makes no sense at all.

22
23 Q. DO YOU AGREE WITH MR. WOOD'S VIEW THAT BELL SOUTH HAS
24 USED TOO LOW A PRODUCTIVITY FACTOR IN ITS PROJECTION
25 OF EXPENSES?

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A. No. Mr. Wood has not performed any studies or provided any reasonable evidence that would indicate that the 3.1% productivity factor used by BellSouth for projecting certain expenses in its study is understated. He has merely referenced a factor previously used by the FCC for adjusting prices in its interstate price cap formula and opined that the South Carolina Commission should require BellSouth to use a productivity factor in its expense forecasts that is no less than the FCC's 6.5% productivity factor.

It is also important to recognize that the 6.5% factor Mr. Wood references is purported to be a reflection of total factor productivity that would include not only expense inputs but also capital inputs. Since capital inputs would be reflected in the denominator of the shared and common cost factor, any reduction due to productivity in capital inputs would actually increase the shared and common cost factors.

Mr. Wood also fails to recognize that expense changes are only one part of overall productivity. As I have previously explained, BellSouth's shared and common factors are based on the relationship between projected expenses to projected investments, and applied against forward-looking investments. Therefore, the development and application of BellSouth's factors to forward-looking investments reflects some inherent productivity gains.

1

2 Q. IS MR. WOOD CORRECT THAT BELL SOUTH SHOULD NOT APPLY
3 AN INFLATION FACTOR IN ITS PROJECTION OF PERSONAL
4 COMPUTER EXPENSE?

5

6 A. No. Regarding Mr. Wood's 10-year trend analysis for Account 6124,
7 this information provides little help in projecting these expenses
8 forward. During this period of time the Company has consolidated data
9 centers, outsourced some of the computer operating functions, and re-
10 organized parts of its business. All of these events had significant
11 impacts on the amount of expense in this account, and in this case it
12 would be a mistake to assume that the historical trend is an accurate
13 indication of the future.

14

15 This account includes items such as the salary and wages for computer
16 operating personnel and the cost of power to run data centers. It does
17 not include the capital cost of purchasing computers. It is certainly
18 logical to expect that inflation will impact salaries and wages and power
19 expense in the future.

20

21 For the reasons explained above, Mr. Wood's adjustment should be
22 rejected.

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25 Q. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?

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2 A. Yes, it does.

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STATE OF SOUTH CAROLINA)
) CERTIFICATE OF SERVICE
 COUNTY OF RICHLAND)

The undersigned, Susan Davis Gibson, hereby certifies that she is employed by the Legal Department for BellSouth Telecommunications, Inc. ("BellSouth") and that she has caused the Rebuttal Testimony of Walter S. Reid to be served by placing such in the care and custody of the United States Postal Service, with first-class postage affixed thereto and addressed to the following this June 11, 2001:

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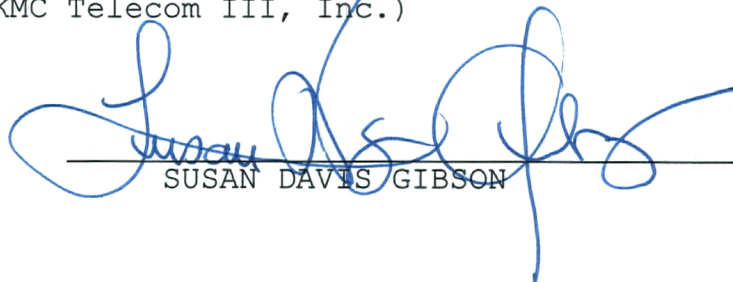
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